California Debt and Investments Advisory Commission
Mechanics of a Bond Sale

Developing a Debt Management Policy

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Plans vs Policies

> "Plans are nothing; planning is everything."
>
> ***Dwight D. Eisenhower***

- Plans change over time as actual results replace assumptions (like, as soon as the laser jet ink is dry).
- But policies:
  - Are your "north star" guiding preparation of plans.
  - Help making tough decisions easier by telling you what your values are before they are placed under stress by adverse circumstances.
  - You might actually do something else, but they are a powerful starting point:
    - *But for "this," I would do . . . what?*

Debt Management Policies

- No right answers.
- Only right questions.

GFOA Recommended Practices

- Conducted survey of debt policies, ranked by commonality.
  - Most common feature was the “purposes and uses for which debt may be issued.”
- Provides good benchmark for drafting your own.

Common Elements in Debt Policy Statements

1	Purposes and uses of debt	19	Sale process
2	Types of debt	20	Assessed value
3	Capital expenditures	21	Analysis requirements
4	Refunding bonds	22	Reserve capacity
5	Disclosure	23	Per capita limitations
6	Statutory limitations	24	Size of issuance
7	Project life	25	Intergovernmental coordination
8	Rating agency relations	26	When not to issue debt
9	Operating budget	27	Operating revenue
10	Revenue and TIF bonds	28	Lease debt
11	Bond rating goals	29	Capitalized interest guidelines
12	Misc. limitations	30	Market value limitations
13	Repayment provisions	31	Credit enhancement
14	Maturity guidelines	32	Limited tax GO bonds[1]
15	General fund revenue	33	Inter-fund borrowing
16	Expenditure limitations	34	Variable rate debt
17	Professional services	35	Debt service funds
18	Short-term debt	36	Derivatives

[1]In California, effectively a lease obligation

Fitch Rating Agency: Mgt Practices

- Very Significant
  - Fund balance policy
  - Debt affordability policy
- Significant
  - Pay-as-you-go capital financing
  - Multi-year forecasting
  - Quarterly reporting
  - Quick debt retirement
- Influential
  - Contingency plans
  - Non-recurring revenue policy
  - Depreciation of fixed assets (GASB 34 implementation)
  - 5 Year CIP integrating operating cost impacts
  - GFOA financial reporting award
  - GFOA budgeting award

Report is included in your binders

Standard & Poor's Top Ten Practices

- Established budget reserve
- Regular economic and revenue reviews
- Prioritized spending plans and established contingency plans
- Formal capital improvement plan
- Long-term planning
- Debt affordability model
- Pay-as-you-go financing
- Multi-year financial plan
- Effective management and information systems
- Well-defined and coordinated economic development plan

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Basic Questions to be Addressed in a Debt Policy

- What is the reason for the financing?
- What is the legal authority for issuance of the debt?
- How will the debt be repaid?
- Will bonds be sold with an investment grade rating and who will be the ultimate purchasers?
- What are the qualifications of the professional advisors and underwriters assisting in the financing?
- What is the proposed method of selling the debt?

What is the reason for the financing?

- Is the project to be financed well defined and approved?
  - Have construction bids been received?
- Should the project be financed by bonds or by “pay as you go” funds?
  - By borrowing, the people who benefit from the project will be paying for it.
  - Important to maintain healthy cash reserves.
  - Never finance maintenance costs.

What is the legal authority for the issuance of debt?

- Financing plan should identify the legal statute that permits the issuance of the debt
  - Issuer’s Bond Counsel will provide it in its Bond Opinion

How will the debt be repaid?

- Will the project being financed generate its own revenues?
  - Will bonds be sized off just off the revenues?
  - How will on-going maintenance be paid for?
- Will the issuer’s General Fund have to be pledged?
  - What is the impact on future budget flexibility?
- How will issuing debt effect debt ratios for issuer?
  - Debt ratio (and debt service) as a percentage of General Fund Balance
  - Debt ratio on a per capita basis
  - Debt ratio as a percentage of Assessed Value

What is the rating requirement for bond being issued?

- Will bonds only be sold if they achieve minimum investment grade rating (BBB-)?
- Will bond insurance be considered?
- Will non-rated bonds be considered for issuance?
  - Land Secured
- To whom will the bonds be marketed?
  - Suitability

What are the qualifications of the professional advisors/UW?

- Will the issuer create a pool of professionals to use on all its financings”
  - Bond Counsel, Disclosure Counsel, Financial Advisor, Special Tax Consultant, Appraiser
  - Benefit from working with core team of consultants but periodic review is important
- Selection of an Underwriter for negotiated deals
  - On a RFP basis for each financing?
  - Create a pool of Underwriters and select from this pool for each financing?
  - At a minimum, each firm should demonstrate its credentials for each type of financing
  - Land Secured

Proposed Method of Sale?

- Negotiated Sale
  - Issuer and Underwriter negotiate the rates for the bonds and the Underwriter's discount
  - Useful for bonds that have a "story," need special consideration for who can buy them or to preserve market flexibility
  - Typically require independent consultant to verify "on the market" pricing
- Competitive Sale
  - On an advertised date, issuer receives bids from all the banks who wish to buy the bonds
  - By definition, is on the market pricing
  - Typically used fore "vanilla" transactions with a simple story and a straightforward structure

Example of Debt Policy: Land-Based Financings

- Clear Public Purpose
- Active Role by issuer
- Applicant Credit Quality
- Reserve Fund
- Capitalized Interest
- Value-to-Lien Ratio
  - Minimum 3:1
- Annual Maximum Special Tax Burden
  - No more than 2% of value of home
- Maximum Burden of Tax
- Benefit Apportionment
- Special Tax District Administration
- Foreclosure Covenants
- Disclosure to Bond Holders
- Disclosure to Prospective Purchasers

Example of Debt Policy: Interest Rate Swaps

- Not to be used for speculative purposes
  - Always be in combination with underlying bonds.
- Define maximum level of swaps in a portfolio.
- Level of Tax Risk that is acceptable
  - LIBOR swaps versus BMA Swaps
- Counterparty Exposure
  - Minimum of AA-
- Evaluating Termination Payment exposure.

Example of Debt Policy: Refundings

- Standard rule of thumb is to achieve present value savings of 3% to 5% of refunded bond issue.
  - You can only do one “advance refunding;” make it count.
  - Higher savings appropriate if period to call is long.
  - Restructuring opportunity in the future?
  - Yield curve management.
- Flexibility

Summary

- Policies Are Powerful
  - Fundamental foundation for long-term fiscal health: underlying basis for case-by-case decision-making.
  - Provides context for what you would "but for."
  - Essential component of any "contingency plan."
  - Articulates your values before they are under stress.

Questions?